TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #97-31

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Applicability of Tennessee recordation tax (Tennessee Code Annotated § 67-4-409(a)) to recordation of deeds where transferor is 100% owned by transferee, a federal tax-exempt title holding company under Internal Revenue Code § 501(c)(2), and transferee is 100% owned by a pension plan which is both qualified under the Internal Revenue Code and subject to the provisions of the Employee Retirement Income Security Act (ERISA).

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

(A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
(B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
(C) The applicable law must not have been changed or amended;
(D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
(E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

[THE TAXPAYER] is a Delaware corporation organized and existing under the laws of the State of Delaware. The Taxpayer has filed for and received a Tennessee Certificate of Authority as a corporation for profit. The Taxpayer's office is [ADDRESS]. The Taxpayer's federal employer identification number is [NUMBER].

The sole stockholder of the Taxpayer is the [TRUST] Pension Trust - Plan #[NUMBER]. The Trust is a federal tax-exempt organization qualified under the Internal Revenue Code and is also subject to the provisions of the Employee Retirement Income Security Act (ERISA) as set forth in 29 U.S.C. §§ 1001-1461. The address of the Trust is [ADDRESS] and the federal employer identification number is [NUMBER].

The Taxpayer has received a favorable determination letter from the IRS for exemption from federal income tax under I.R.C. § 501(c)(2) as a corporation organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is a tax-exempt entity (i.e., the Trust). The sole purpose of the Taxpayer is to own, operate and hold, either directly or indirectly through a limited liability company, an interest in certain retail shopping centers located in Tennessee, on behalf of and for the sole benefit of the Trust.

By letter dated [DATE], the Taxpayer requested that the Commissioner of Revenue issue a letter ruling that neither the Tennessee franchise tax nor the Tennessee excise tax will be applicable to the Taxpayer. On the date of that letter, it was anticipated that certain property located in the [CITY AND COUNTY], Tennessee (the Property), would be acquired, ultimately for the benefit of the Trust**,** towards the end of [MONTH AND YEAR].

The Taxpayer hoped that the Commissioner would issue a favorable ruling on the [DATE] request before the closing of the Property acquisition. With a favorable ruling in hand, the property would have been acquired directly by the Taxpayer, to be held for the benefit of the Trust.

However, the Seller of the Property was not willing to defer the closing until a favorable tax ruling from the Commissioner was received. Therefore, title to the Property was acquired by [NAME], a Delaware limited liability company (LLC), of which the Taxpayer is a 1% member and the Trust is a 99% member.

The Commissioner issued Letter Ruling 97-1 on January 22, 1997 concluding that the Taxpayer would not be subject to Tennessee franchise, excise taxes.

To simplify the ownership and operation of the Property on behalf of the Trust, the Trust plans to contribute to the Taxpayer the Trust's 99% membership interest in the LLC. The LLC would then transfer by warranty deeds the Property to the Taxpayer. The Taxpayer, being 100% owned by the Trust, would then own the Property directly on behalf of the Trust and for the sole benefit of the Trust.

ISSUES

1. Are the recordations of warranty deeds to real property, where the transferor is a limited liability company 100% owned by the transferee, an IRC § 501(c)(2) federal tax-exempt title holding company, and the transferee is 100% owned by a pension plan which is both qualified under the Internal Revenue Code and subject to the provisions of the Employee Retirement Income Security Act (ERISA), subject to the Tennessee recordation tax under Tennessee Code Annotated § 67-4-409(a)?

2. Is the application of Tennessee Code Annotated § 67-4-409(a) to the recordation of warranty deeds under the circumstances given preempted by ERISA?

RULINGS

1. Yes.

2. No.

ANALYSIS

1. THE RECORDATIONS OF WARRANTY DEEDS FROM LLC TO TAXPAYER ARE SUBJECT TO THE TENNESSEE RECORDATION TAX

In general, the recordation of a deed transferring Tennessee realty from one party to another results in the imposition of the recordation tax under Tennessee Code Annotated § 67-4-409(a). The recordation tax is a privilege tax which is imposed and is to be paid for the privilege of having the deed recorded.

The tax is not due in the case of the transfer of leasehold estates. (T.C.A. § 67-4-409(a)(2).) Neither is it levied upon certain interspousal transfers, deeds of division in kind, life estate releases to remainder beneficiaries, executor's deeds implementing testamentary transfers, domestic settlement and other decrees adjusting property rights between divorcing parties or transfers of realty to revocable living trusts. (T.C.A. § 67-4-409(a)(3)(A)-(F).) None of these exceptions to the applicability of the tax would apply in this case.

The Tennessee statute also contains certain specific exemptions from the tax applicable to corporate mergers, consolidations, sales or transfers of substantially all assets (T.C.A. § 67-4-409(e)), and transactions in which a municipality is the transferee (T.C.A. § 67-4-409(f).) Neither of these exemptions are applicable since one of the participants in the transaction here, the LLC, is not a "corporation" nor is the Taxpayer a municipality.

The unique characteristics of both the transferor (the LLC) and the transferee (the Taxpayer) - insofar as they pertain to their respective relationships to each other and to a pension trust both qualified under the Internal Revenue Code and subject to the provisions of the Employee Retirement Income Security Act (ERISA) - do not entitle the proposed recording to exclusion from the tax under the Tennessee recordation tax statute. Additionally, no other Tennessee law, to our knowledge, provides for such an exclusion.

The facts presented are that the conveyance of the Property by the LLC to the Taxpayer will be by warranty deeds. On the transfer of freehold estates, the tax base is equal to the greater of the consideration for the transfer or the value of the property pursuant to T.C.A. § 67-4-409(a)(1). Since a warranty deed conveys a freehold estate, the greater value of the Property would constitute the tax base in this case under applicable Tennessee law.[1]

2. THE TENNESSEE RECORDATION TAX IS NOT PREEMPTED BY ERISA

Title 29 U.S.C. § 1144 of the ERISA in essence "preempts" state laws that relate to employee benefit plans subject to that federal statute. Subsection (a) of the statute provides, in part, as follows:

> (a) Except as provided in (b) of this section, the provisions of this title and Title IV shall supersede any and all state laws insofar as they may now or hereafter relate to any employee benefit plan described in § 4(a) (29 U.S.C.S. § 1003(a)) and not exempt under § 4(b) (29 U.S.C.S. § 1003(b)) . . .

Therefore, this statute and judicial interpretations of the statute must be consulted to determine whether Tennessee's recordation tax statute is preempted by ERISA in this instance.

In *Morgan Guaranty Trust Co. v. Tax Appeals Tribunal of New York State Dept. of Taxation and Finance,* 587 N.Y.S.2d 252 (Ct. App. 1992), the primary case cited by the Taxpayer, the New York Court of Appeals held that New York's gains tax was preempted by ERISA. In its opinion, the court outlined several judicial principles which may be considered relevant in this case.

The court's analysis began with a statement of the presumption that State law has not been preempted by Federal statute "in the absence of persuasive evidence to the contrary." *Id.*, at 253. Nevertheless, the court pointed out that ERISA's preemption is indeed broad: all State laws are superseded "insofar as they may now or hereafter relate to any employee benefit

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[1] In the case of quitclaim deeds, the Tennessee law establishes the recordation tax base as the "consideration given for that conveyance." T.C.A. § 67-4-409(a)(4). Were the proposed deeds intended to be quitclaim deeds rather than warranty deeds, a reasonable argument could be made that no consideration would be provided by the Taxpayer to the LLC in this case based on the Tennessee Supreme Court's holding in *Northern Telecom, Inc. v. Olsen,* 679 S.W.2d 448 (Tenn. 1984).

If that argument prevailed, no tax would be incurred since the tax base would be zero. However, no decision is made on that point since the facts presented do not involve quitclaim deeds.

plan." 29 U.S.C. § 1144(a). State laws specifically designed to affect employee benefit plans are viewed as preempted by ERISA.

If (as with the tax law at issue both in *Morgan Guaranty Trust* and in the case at hand) the State tax law is not specifically designed to affect employee benefit plans--if it is a law of general application--the next step is to determine whether the law "relate[s] to" employee benefit plans.

Despite the breadth of the preemption clause, certain State laws "may affect employee benefit plans in too tenuous, remote, or peripheral a manner to warrant a finding that the law 'relate[s] to' the plan." *Morgan Guaranty Trust Co. v. Tax Appeals Tribunal of New York State Dept. of Taxation and Finance,* 587 N.Y.S.2d 252, at 255 (Ct. App. 1992), citing *Shaw v. Delta Air Lines,* 463 U.S. 85. at 100, n. 21, 103 S.Ct. 2890, at 2901, n. 21.

Ultimately, the New York Court of Appeals held in *Morgan Guaranty Trust* that the New York gains tax was preempted by ERISA. The court found that because the tax affected the structure, administration and economics of a covered plan, it "relate[d] to" the plan in more than a tenuous, remote or peripheral way. *Morgan Guaranty Trust Co. v. Tax Appeals Tribunal of New York State Dept. of Taxation and Finance,* 587 N.Y.S.2d 252, at 257 (Ct. App. 1992).

The court found that the gains tax would impose certain recordkeeping and reporting requirements on the Plan, mandating administrative procedures pertaining to asset disposition not required in other jurisdictions. Additionally, it determined that the gains tax would impact the investment strategy of the Plan by directly taxing gains on the sales of assets transferred through the sanction of ERISA. (In fact, the transaction subject to New York's gain tax was a response to ERISA's "prohibited transaction" rules, which required some action to be taken.) *Id.,* at 256. Finally, the economic impact of the New York gains tax upon the Plan was significant in that most of the asset increase projected for ERISA plans in the ensuing decade was estimated to be attributable to the income earned from existing assets in established ERISA plans. Depletion of those earnings (caused by the state gains tax) would necessarily increase the cost of the Plan or decrease the benefits it was able to distribute. *Id.,* at 257.

Unlike the case in *Morgan Guaranty Trust*, the Tennessee recordation tax does not impose any recordkeeping or reporting requirements upon the ERISA plan administered by the Trust. The tax is simply a one-time privilege tax, imposed upon the privilege of recording an instrument of transfer and collectible at the time of recordation with no special reporting requirement.

Also, the Tennessee recordation tax does not appear to affect the structure or administration of the ERISA plan itself or impact its investment strategy through the direct tax upon the sale of assets transferred through the sanction of ERISA. While the recordation of instruments evidencing transfers of real estate in Tennessee would generally be subject to the state tax, these activities can be considered privileges of conducting business in the state and are thus "costs of doing business" in Tennessee, which even the court in *Morgan Guaranty Trust* implied might permit the state tax to withstand preemption. *Id*.

The Tennessee recordation tax could, indirectly, have a significant economic impact upon the ERISA plan administered by the Trust since the recordation tax payable by the Taxpayer will increase the plan cost incurred by the Trust and reduce the funds available for payout of plan benefits. Nevertheless, significant economic impact alone does not appear to be sufficient to establish preemption under the holding in *Morgan Guaranty Trust*. The New York Court of Appeals held that ERISA preempted the state law in that case. However, it found that the New York gains tax "relate(d) to" the plan in more than a tenuous, remote or peripheral way because it affected the "structure, administration *and* economics" of a covered plan. (Emphasis supplied.) *Id*.

The Fifth Circuit Court of Appeals, in *Matter of Dyke,* 943 F.2d 1435 (5th Cir. 1991), listed a number of cases where federal courts had cited *Shaw* for the proposition that ERISA does not preempt state laws which affect benefit plans in a tenuous or remote manner. *See, e.g. Aetna Life Ins. Co. v. Borges*, 869 F. 2d 142, 147 (2d Cir.), *cert. denied,* 493 U.S. 811, 110 S.Ct. 57, 107 L.Ed.2d 25 (1989); *Firestone Tire & Rubber Co. v. Neusser,* 810 F.2d 550, 556 (6th Cir. 1987); *Sommers Drug Stores Employee Profit Sharing Trust v. Corrigna Enterprises, Inc.,* 793 F.2d 1456 ,1466 (5th Cir. 1986), *cert. denied,* 479 U.S. 1034, 107 S.Ct. 884, 93 L.Ed. 837 (1987); *Rebaldo v. Cuomo,* 749 F.2d 133, 139 (2d Cir. 1984), *cert. denied,* 472 U.S. 1008, 105 S.Ct. 2702, 86 L.Ed. 718 (1985). These cases shared one common attribute: the state law in each case was a law of general application.

The Tennessee recordation tax law must be considered a law of general application since it neither targets nor singles out pension plans subject to ERISA but applies generally to the recordation of instruments conveying property interests.

The U.S. Court of Appeals for the Second Circuit, in *Rebaldo*, stated that a preemption provision designed to prevent state interference with federal control of ERISA plans does not require the creation of a fully insulated legal world that excludes these plans from regulation of any purely local transaction. While it was clear to the court that ERISA preempts state laws that require or forbid the provision of a certain kind of benefit, it was equally clear that ERISA does not preempt every state law that incidentally touches pension plans through its effect on individuals. In short, the court concluded that if ERISA is held to invalidate every State action that may increase the cost of operating employee benefit plans, those plans will be permitted a charmed existence that never was contemplated by Congress. *Rebaldo v. Cuomo,* 749 F.2d 133, 138 (2d Cir. 1984). Thus, the court held that where a state law of general application does not affect the structure, the administration, or the type of benefits provided by an ERISA plan, the mere fact that the statute has some economic impact on the plan does not require that the statute be invalidated. *Id.*, at 139.

Although no single test has been formulated for determining when a state law falls within the "remote and peripheral" exception to 29 U.S.C. § 1144, the Sixth Circuit Court of Appeals has cited three factors commonly used by the courts in this analysis. *Firestone Tire & Rubber Co. v. Neusser*, 810 F.2d 550 (6th Cir. 1987). Courts may ascertain: whether the state law is traditionally an area of state authority, whether the law affects the relationships among the principal ERISA entities, and whether the effect on ERISA plans, if any, is incidental. *Id.*, at 555 and 556.

The recordation tax applicable to this case is a law traditionally within the province of state governments. Laws of this type apply to transactions which are local in nature. The U.S. Congress, through the federal bankruptcy statutes, has implicitly conceded that laws of this type are state laws by preempting the application of stamp taxes, transfer taxes and similar taxes upon the recordation of instruments of transfer made pursuant to plans confirmed under the bankruptcy laws. (*See* 11 U.S.C. § 1146(c)[2].)

The courts have indicated that the principal ERISA entities are the employer, the plan, the plan fiduciaries, and the beneficiaries. (*See e.g., Sommers Drug Stores Employee Profit Sharing Trust v. Corrigna Enterprises, Inc.*, 793 F.2d 1456 at 1467 (5th Cir. 1986).) Neither the LLC(transferor) nor the Taxpayer(transferee) constitute principal ERISA entities as those entities have been identified by the court, since those entities are, in this case, [THE ENTITY THAT FORMED THE TRUST], the Trust itself and the Trust's fiduciaries and beneficiaries.

Finally, the effect which the Tennessee recordation tax has upon the ERISA plan administered by the Trust in this case is at best incidental. The following language of the District Court, cited with approval by the Sixth Circuit Court of Appeals in *Firestone*, is equally applicable to the case at hand: "The tax has no connection or reference to the benefit plans. The tax commissioner has not directed any action at the plan contributions or payments." *Firestone Tire & Rubber Co. v. Neusser*, 810 F.2d 550, 556 (6th Cir. 1987), citing District Court Opinion at 9-10.

The Department believes that the state law at issue and the facts of this case are more nearly analogous to those in *Thiokol Corp. v. Roberts*, 858 F.Supp. 674 (W.D.Mich. 1994). In *Thiokol*, Michigan's state business tax (SBT), a value added tax, was the state law in question. The U.S. District Court for the Western District of Michigan held that such tax was not preempted by ERISA, even though tax was calculated by reference to plan contributions.

The facts upon which the court based its conclusion were stated as follows:

> (1) The SBT is a neutral tax of general application which does not single out ERISA plans for special treatment nor predicate rights or obligations on the existence of such plans.
> (2) The SBT does not regulate ERISA plans.
> (3) The SBT does not affect ERISA plans or the relationships between, or among ERISA entities.
> (4) The SBT is neither a direct nor indirect tax on employer contributions to ERISA plans. The SBT is a value added tax, akin to a sales tax, which merely does not allow a deduction for ERISA contributions made by an employer.

[2] The specific preemption by Congress of stamp taxes and similar taxes found in the federal bankruptcy law seems to suggest that such state laws would <u>not</u> be <u>generally</u> preempted by ERISA but would only be preempted by ERISA if there was a specific provision for such, thus demonstrating congressional intent that preemption apply.

> (5) Any minimal effect the SBT may have on employer contributions to ERISA plans is incidental and unavoidable; such an effect could be found in nearly every state law which regulates business. This incidental effect is tenuous, remote and peripheral.

Id., at 684.

Similarly, the Tennessee recordation tax: is a neutral tax of general application which fails to single out ERISA plans in any way; does not regulate ERISA plans; does not affect such plans or the relationships between, or among ERISA entities; and is neither a direct nor indirect tax on employer contributions. The Tennessee recordation tax has no effect at all upon employer contributions to ERISA plans, whereas even in *Thiokol*--where a preemption argument was rejected--the SBT had a minimal effect on such contributions.

All things considered, the Tennessee recordation tax must be considered a state law whose effect on employee benefit plans is too tenuous, remote, or peripheral to justify a finding that it is preempted by ERISA.

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APPROVED: Ruth E. Johnson

DATE: 7/9/97